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C O N F I D E N T I A L SECTION 01 OF 02 QUITO 000900

SIPDIS

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TAGS: [PGOV](#) [PREL](#) [PINR](#) [EC](#)

SUBJECT: ECUADOR TO REVERSE ECONOMIC POLICY?

Classified By: Amb. Kristie A. Kenney for reasons 1.4 (b) and (d).

11. (U) Summary: Public pronouncements by and reports from private meetings with the new Ecuadorian Minister of Finance and Economy suggest that the GOE's economic policy will be making a U-turn. Fiscal responsibility is to be replaced with increased social spending. The intent to pay off debt early has been replaced with a political preference for default. End Summary.

12. (U) Rafael Correa, the new (and young) Minister of Finance of the Palacio government has already made a big splash on the morning talk show circuit. On as many as three programs a day since his appointment three days ago, he has preached the benefits of a new solidly left economic policy. He has stated that Ecuador cannot continue paying debt at current rates and that he would favor a "political" re-negotiation; that the earnings from petroleum should be used for social spending; that state pension funds should be invested in Petroecuador; and that Petroecuador's fields should not be operated by private companies. Although he is one of dollarization's most forceful opponents, Correa stated publicly that he recognizes that dollarization cannot be reversed.

13. (U) Correa is 43. He earned a Masters degree and a Ph.D. in Economics at the University of Illinois at Urbana-Champaign. Offered a USAID scholarship to study in the U.S., he instead accepted a scholarship from the Belgian government and earned a Masters degree (also in economics) at the Universite Catholique de Louvain. Correa has taught economics at various Ecuadorian universities ever since 1983, only leaving Ecuador to earn his graduate degrees abroad.

14. (U) Correa debated the merits of the U.S.-Andean FTA against EconCouns three months ago at a local university. Correa argued that David Ricardo was wrong about comparative advantage, that free trade with the U.S. is a dangerous mistake (though free trade with Europe would be much more sensible, he said), that dollarization has been a disaster for Ecuador, and that the Washington consensus has been applied in Ecuador and Latin America for 20 years and has failed. During the debate and in discussion before and afterward it was clear that Correa is highly intelligent, but also extremely stubborn and unwilling to reconsider entrenched ideas and positions.

15. (C) Central Bank President Mauricio Pareja asked to meet with Econcouns on April 22. He expressed concern about the effects Correa's statements were already having on markets, stating that some capital flight has already taken place and he fears more is likely. He asked for advice in approaching Correa. Econcouns suggested that he enter the meeting in a listening mode, and then, rather than arguing policy, attempt to provide Correa with the information necessary for him to realize for himself how erroneous his initial policy inclinations were.

16. (C) Pareja called Econcouns April 23 to report on his meeting. He said that Correa started the meeting by asking Pareja to develop alternative scenarios for a default on foreign debt. Pareja responded that he could do so, of course, but that default was by no means necessary. Correa asked whether there were any funds available to the GOE for expenditure, and Pareja affirmed that the GOE had approximately 200 million in its general account. All state accounts had been frozen in the days before the overthrow of Gutierrez to ensure that government officials could not make last minute withdrawals. Further, there is more than \$300 million in the oil stabilization fund (FEIREP), which could be accessed if the legal restrictions on the funds were eliminated. (Note: These funds are mostly reserved for debt repayment, but were churned through the Social Security Fund and used for current expenditures under the Gutierrez government. End Note.) Pareja's sense was that, overall, the meeting had gone reasonably well. He said, however, that Correa commented that he had no choice but to continue with his public statements. They had agreed to meet again on Monday to review accounts in greater detail.

17. (C) Econcouns has been in constant contact with Citibank's local manager Francisco Aristigueta since the political crisis began. According to Aristigueta, capital flows have been remarkably small. A few clients had begun moving money out of the country on Thursday, and that trickle

had continued on Friday. There have been no signs of a run on banks. However, Aristigueta and Pareja both believe that if Correa continues on the path he has set out for himself publicly, capital flight will pick up and a run on the banks is possible.

18. (U) IDB, IBRD, and IMF representatives all expressed concern about the situation at a meeting with Econcouns on April 22. IDB and IBRD both have substantial loan outlays coming up, which hinge on the GOE's demonstrating commitment to the responsible policies of the past two years - the opposite of what Correa is announcing. They are also quite concerned about the prospect of default. They laughed a bit to themselves about CAF, though, which has \$2 billion in exposure in Ecuador. The three agreed on a joint request to meet the new minister and introduce themselves, and also agree with Econcouns that listening was the best mode for the first meeting. The representatives intend to offer individual organizational follow-ups to brief Correa on their individual programs.

19. (U) Econcouns requested a meeting with Correa on April 21 and 22. So far, there has been no response. We will renew the request again on April 25.

KENNEY